

of this section as deductions from that activity for 1995.

(g)(1)-(g)(4)(ii)(B) [Reserved]

(g)(4)(ii)(C) Portfolio income (within the meaning of § 1.469-2T(c)(3)(i)), including any gross income that is treated as portfolio income under any other provision of the regulations (See, e.g., § 1.469-2(c)(2)(iii)(F) (relating to gain from the disposition of substantially appreciated property formerly held for investment) and § 1.469-2(f)(10) (relating to certain recharacterized passive activity gross income))

(5) [Reserved]

(h)(1) *In general.* This paragraph (h) provides rules for applying section 469 in computing a consolidated group's consolidated taxable income and consolidated tax liability (and the separate taxable income and tax liability of each member).

(2) *Definitions.* The definitions and nomenclature in the regulations under section 1502 apply for purposes of this paragraph (h). See, e.g., §§ 1.1502-1 (definitions of group, consolidated group, member, subsidiary, and consolidated return year), 1.1502-2 (consolidated tax liability), 1.1502-11 (consolidated taxable income), 1.1502-12 (separate taxable income), 1.1502-13 (intercompany transactions), 1.1502-21T (net operating losses (temporary)), and 1.1502-22T (consolidated net capital gain and loss (temporary)).

(3) [Reserved]

(4) *Status and participation of members*—(i) *Determination by reference to status and participation of group.* For purposes of section 469 and the regulations thereunder—

(A) Each member of a consolidated group shall be treated as a closely held corporation or personal service corporation, respectively, for the taxable year, if and only if the consolidated group is treated (under the rules of paragraph (h)(4)(ii) of this section) as a closely held corporation or personal service corporation for that year; and

(B) The determination of whether a trade or business activity (within the meaning of paragraph (e)(2) of this section) conducted by one or more members of a consolidated group is a passive activity of the members is made by reference to the consolidated group's participation in the activity.

(ii) *Determination of status and participation of consolidated group.* For purposes of determining under § 1.469-1T(g)(2) whether a consolidated group is treated as a closely held corporation or a personal service corporation, and determining under § 1.469-1T(g)(3) whether the consolidated group materially or significantly participates in any activity conducted by one or more members of the group—

(A) The members of the consolidated group shall be treated as one corporation;

(B) Only the outstanding stock of the common parent shall be treated as outstanding stock of the corporation;

(C) An employee of any member of the group shall be treated as an employee of the corporation; and

(D) An activity is treated as the principal activity of the corporation if and only if it is the principal activity (within the meaning of § 1.441-4T(f)) of the consolidated group.

(5) [Reserved]

(6) *Intercompany transactions*—(i) *In general.* Section 1.1502-13 applies to determine the treatment under section 469 of intercompany items and corresponding items from intercompany transactions between members of a consolidated group. For example, the matching rule of § 1.1502-13(c) treats the selling member (S) and the buying member (B) as divisions of a single corporation for purposes of determining whether S's intercompany items and B's corresponding items are from a passive activity. Thus, for purposes of applying § 1.469-2(c)(2)(iii) and § 1.469-2T(d)(5)(ii) to property sold by S to B in an intercompany transaction—

(A) S and B are treated as divisions of a single corporation for determining the uses of the property during the 12-month period preceding its disposition to a nonmember, and generally have an aggregate holding period for the property; and

(B) § 1.469-2(c)(2)(iv) does not apply.

(ii) *Example.* The following example illustrates the application of this paragraph (h)(6).

*Example.* (i) P, a closely held corporation, is the common parent of the P consolidated group. P owns all of the stock of S and B. X is a person unrelated to any member of the P group. S owns and operates equipment